APPENDIX 1

MJ HUDSON

London Borough of Bromley

Quarterly Report

Q1 2021

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Performance Summary

Markets continued to improve during the first quarter of 2021 driven by successful vaccination rollouts in a number of countries and the expectations of a rapid economic recovery as lockdowns are eventually eased, whilst, at the same time, worrying over two distinct fears: firstly, a resurgence of the Covid-19 pandemic lead by a new strain which may be immune to the current crop of vaccines and, secondly, and more structurally, the outlook for inflation. It is the concern over inflation which will set the tone of market behaviour over the next few years and into the longer term. UK Government Bond yields rose (prices fell) across all developed markets at the fastest rate for over 20 years during the first quarter and are now back towards pre COVID-19 levels. In the UK, 10-year Government Gilt yields rose from 0.2% at the start of the quarter to 0.85% by the end of March. Gilt yields are still below the levels of March 2019, the time of the last actuarial valuation and so will still have a negative impact on the Fund's funding level but my expectation is for UK Gilt yields to rise further over the next 12 months and, as such, this should be supporting of the funding level by the next actuarial revaluation in March 2022.

Total Fund Performance

I have not received the quarterly report from your custodians at the time of writing.

Based on the information supplied by your officers, I believe the Fund rose by 1.6% over the quarter to a value of £1.334bn. This figure is a total of the figures provided by your asset managers and not the custodian and is therefore liable to change. I estimate that the Fund underperformed the Strategic Asset Allocation (SAA) Benchmark by approximately 0.5% - 0.8% over the quarter. This was driven mainly by the underperformance of the Baillie Gifford High Alpha Global Equity portfolio, balanced by outperformance by the MFS global equity portfolio and by the Fund's overweight exposure to Equities. The Baillie Gifford Global Alpha Portfolio has outperformed substantially over the last 12 months.

Asset Allocation

With equity markets continuing to rise over the quarter and bonds falling, the Fund's tactical asset allocation has deviated further from the SAA Benchmark.

In the short term, the expectation of a strong recovery in earnings is pushing equities higher whilst also pushing bond yields up (prices down) which acts as a headwind on equity valuations. Market sentiment is at stretched levels suggesting investors are becoming over committed and the economic recovery increasingly priced in.

Asset class	Asset Allocation as at 31/12/2019	SAA as at 31/12/2019	Position against the existing SAA	Asset Allocation as at 31/3/2021	New SAA going forward	Position against the new SAA
Equities	64.6%	60%	+4.6%	66.7%	57.5%	+9.2%
Fixed Interest	12.7%	15%	-2.3%	11.6%	12.5%	-0.9%
Property	4.2%	5%	-0.8%	3.5%	5%	-1.5%
Multi-Asset Income	18.5%	20%	-1.5%	18.2%	20%	-1.8%
Int'l Property	n/a	n/a	N/a	0%	5%	-5.0%

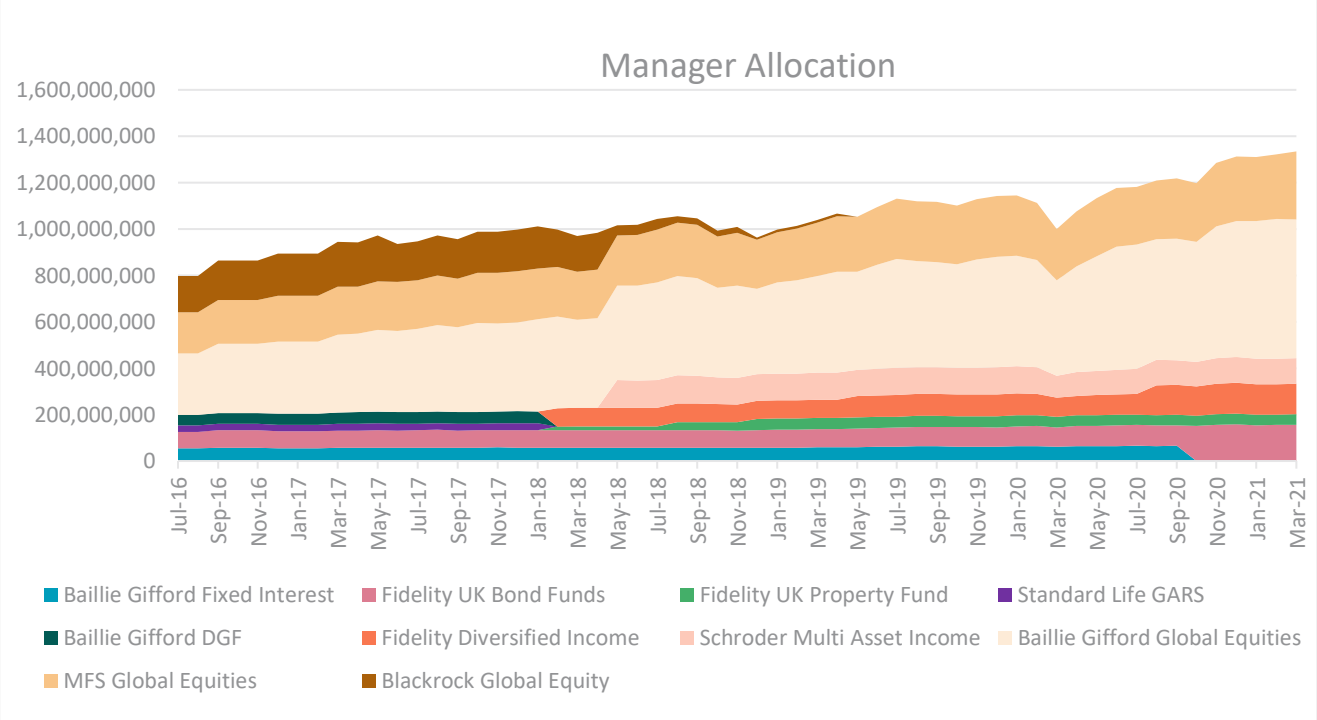
Figures may not add up due to rounding

The Fidelity UK Property manager is presenting to the Committee at this meeting. The Fund is underweight this portfolio against its SAA by 1.5% (see table above). This property portfolio currently has a number of unlet properties on which it receives no income at present, these account for close to 20% of the value of the portfolio. The majority of this relates to 4 properties currently undergoing refurbishment of which 3 were planned pre COVID-19. The manager presentation will give the committee the opportunity to question progress to reletting these assets and hopefully give some comfort on the ability of this portfolio to create value for the Fund going forward.

Recommendation 1: To Discuss whether to add £20m to the UK Property Portfolio to bring its weighting back into line with the SAA. The money to come from the Fund's equity managers.

Recommendation 2: To allocate an additional £20m to the Fund's Multi Asset Income portfolios to bring their weighting back to the SAA. The money to come from the Fund's equity managers.

The chart below shows the Fund's assets by manager/mandate



The switch from the Baillie Gifford Fixed Interest portfolio to the Fidelity UK Corporate portfolio was completed at the end of the third quarter 2020.

Because the Fund's investment return has surpassed the level assumed by the actuarial discount rate at the 2019 actuarial revaluation (3.65%), the funding level should have improved, all else being equal. Of course, everything else has not stayed

constant and the Fund's liabilities will have increased slightly due to the McCloud judgement and a number of other legisaltive issues. In addition, falling yields on UK Government Gilts may also have affected the actuaries' calculation of the discount rate. These calculations are for the Fund as an open, on-going Defined Benefit Scheme. If the Scheme was to close, less risk could be taken within the investment portfolios and the discount rate would be lower.

Cash Flow

Currently, the Fund can cover pension and lump sum payments as well as its manager fees and admin costs from pension contributions and the investment income received. Investment income is reinvested within the Global Equity and Fixed Income portfolios and paid out from the Multi-Asset Income and UK Property portfolios.

My understanding from discussions with your officers is that the Fund should end this financial year (2020/21) with around £8m in cash and currently has a positive cash flow of around £2m per annum being the net figure of pension contributions and income taken from the Multi-Asset Income and UK Property portfolios set against pension payments and administration costs. I will confirm this figure with your officers when the accounts for the financial year end are completed.

The commitment to International Property via the Morgan Stanley fund has now been signed and US$80m will be drawn down over the next 4 years. The committed capital is an absolute US Dollar cash figure and will not alter even if the value of the Fund falls. It is important not to become a forced seller of assets as the drawdowns into this fund are made. Due to this I would suggest keeping enough cash in the portfolio to finance six months forecast drawdowns into the new fund.

Recommendation 3: To hold 6 months forecast drawdown into the Morgan Stanley International Property Fund as cash (approx. $10m/£7m). This currently requires no action but will be monitored quarterly in my report going forward.

Long Term Capital Market (LTCM) Assumptions

The Strategic Asset Allocation Review conducted by MJHudson in 2019 used Long Term Capital Market Assumptions (LTCM) to calculate the potential risk and return balance of the Fund and the Strategic Benchmark.

LTCM assumptions cover both the expected long-term (10-year plus) return forecast and a calculation of the historic volatility and correlation across asset classes. Many investment managers and consultants produce LTCM assumptions, I have found those produced by JP Morgan to be the most detailed and consistent over time.

The table below shows JP Morgan's LTCM forecasts from December 2019, which were used in the Fund's SAA Review and the most recent version to give an indication of what has changed. It is difficult to include multi-asset portfolios such as Multi-Asset Income in this as the manager can alter the asset allocation across asset classes.

Asset Class	LTCM 2020 Forecast	LTCM Feb 2021 Forecast	Direction	Correlation with Global Equities
UK Inflation	2.0%	2.0%		0.03%
UK Cash	1.8%	1.1%	↓	-0.10%
UK Gilts	0.0%	-0.2%	↓	0.00%
UK Investment Grade	2.0%	1.9%	↓	0.42%
UK FTSE All Share	6.3%	6.8%	↑	0.89%
MSCI World Equity	5.0%	4.3%	↓	1.00%
Private Equity	7.3%	7.0%	↓	0.68%
UK Real Estate	5.5%	5.9%	↑	0.32%
Global Infrastructure	4.5%	5.3%	↑	0.17%
Private Debt	5.5%	6.0%	↑	0.16%
Gold	1.5%	2.1%	↑	-0.06%

JP Morgan tend to assume an element of mean reversion in valuations over time, this is particularly evident in the Equity forecasts where the heavy weighting of US Equities in the Global Equity line and the high current valuation of this market leads to a low future return forecast.

The table above reaffirms the results of the SAA Review and the new Strategic Benchmark agreed by the Pensions Committee in 2020. Return expectations for UK Gilts and Global Equities are falling whilst forecast returns from Infrastructure, Property, Private Equity and Private Debt are rising.

The long-term return forecast for the Total Fund level was 4.6% per annum at the time of the 2019 review. Because of the Fund's heavy exposure to Global Equities and Fixed Interest, this may have fallen towards 4.2% per annum but will still be above the Actuarial Discount rate of 3.9% per annum.

Environmental, Social and Governance

During the quarter the Fund received documentation from both of their two equity managers relating to the Shareholder Rights Directive II (SRD II) which came into effect in mid-2019. SRD II requires EU and UK institutional investors and asset managers to make certain disclosures relating to shareholder engagement and stewardship activities.

To comply with the requirements of SRD II, both managers disclosed: (i) their engagement policy (which can be found on their website); (ii) annual guidance on how our policy has been implemented (with further details available in their quarterly Stewardship Reports); and (iii) an annual report for institutional investors (the "Annual Report").

The Annual Report details items such as key medium-to-long term risks, portfolio composition, turnover and turnover costs, and is aimed at encouraging a long-term approach to investing, an approach which the Fund considers to be a core tenet of its investment philosophy as it seeks to allocate capital responsibly on behalf of its clients.

In addition, we continue to receive updates on engagement from both managers in their quarterly reports and both are looking to comply with the requirements of the Taskforce for Climate related Financial Disclosure (TCFD) which will come into force for the Fund in 2022. It is intended to provide training to Committee Members and Officers on this element during the coming year.

Executive Summary

- The main opposing themes of the last quarter continued to dominate market sentiment in the first quarter of 2021, namely, a concern over a resurgence in COVID-19 cases set against the optimism that the vaccine rollout globally will bring a rapid economic recovery. The resurgence of COVID-19 cases has led to renewed restrictions in some countries, whilst the vaccine rollout out across the developed world continues, albeit unevenly.
- In the US, following the Georgia Senate run-offs, the Democrats now have de facto control of the Senate. Along with the Democrat President and Congress, this provides scope for the implementation of Democrat policies, as seen with the US$1.9 trillion stimulus package (which, at 6% GDP, represents around twice the assumed negative shock caused by COVID-19). This resulted in some fears of overheating the US economy: government bond yields jumped for most developed markets, with bond prices falling (yields rising) significantly, spurring an equity rotation in the favour of value stocks. Oil and copper prices continued to rebound due to increased demand.
- GDP growth estimates for both the UK (-2.6%) and EU (-1.2%) are negative for the first quarter of 2021 and a contraction is also expected in Japan (-1.2%) following a renewed state of emergency. The US (+2.5%) is forecast to have positive growth. While Asian nations have maintained low COVID-19 caseloads over the quarter and high levels of economic normality, the speed of the vaccine rollout in the UK and US is expected to provide tailwinds going into Q2. New lockdown restrictions being implemented in mainland Europe due to a "third wave" are expected to limit growth in the short-term. However, overall expectations of an economic rebound in 2021 have increased - S&P Global have revised their forecast of 2021 global GDP growth up from +5.0% to +5.5%.[1]
- **It is worth highlighting the following themes, impacting investment markets:**

[1] S&P Global "Global Economic Outlook Q2 2021: The Recovery Gains Traction as Unevenness Abounds", March 2021.

- **Policy is expected to remain loose (with the balance shifting from monetary to fiscal support):** Despite the recent rise in government bond yields (see below), central banks have generally recommitted to keeping interest rates near historic lows. Likewise, governments continue to pursue supportive policies, such as a US$1.9 trillion stimulus package in the US, along with a proposed US$2.25 trillion infrastructure plan; the UK 2021 budget was broadly supportive in the short-term; and the EU recovery fund continues to progress towards implementation.
- **An accelerating but uneven recovery:** Differential rates of COVID vaccination and differing amounts of government fiscal stimulus are likely to make the recovery uneven across regions, with the US and Chinese economies in the lead, the UK leading Europe and challenges for some emerging economies (notably in LATAM).
- **Inflation continues to be a concern:** As the prospects of an economic recovery combine with central banks acceptance for higher inflation levels as the cost for such as recovery, markets continue to be wary of potential rising inflation and economies overheating. Whilst central banks are currently committed to low interest rates, investors may have less appetite than previously for low yielding government bonds, especially during a post-COVID-19 recovery.
- **Growth to Value style rotation:** Within equity markets, expectation of rising rates, rising inflation and a recovery in GDP led 'Value' as a style outperformed 'Growth' by 9.5% over Q1, reversing a long trend in the opposite direction. While the market may now have discounted the short-term uptick in inflation caused by year-on-year comparisons, it probably has not yet fully discounted a longer-term increase (20-year UK inflation expectations have only increased by 0.25% year-to-date).
- **Falling bond prices help with the search for yield and Pension Fund funding ratios:** The increase in government bond yields in Q1 (+65 bps for 10-year UK Gilts) has taken yields back to pre-COVID levels in the UK and US. However for local government pension schemes (LGPS) approaching a triennial valuation in 2022, it is worth remembering that UK yields are still some 30 bps below their level at the last valuation in March 2019.

- Global equities had a strong Q1 overall, although gains were not as substantial as those observed over Q4 2020. Vaccine rollouts; the US fiscal stimulus package and a rebound in global demand supported equities throughout the quarter, with the more economically sensitive sectors leading the way. Equity markets performed well in Q1 and all regions delivered solid returns, with the MSCI World up +5.0%. Volatility, measured by the VIX index, fell -15% over the quarter, from 22.8 to 19.4.
  - US equities, measured by the S&P 500, gained +6.2% over Q1, supported by the approval of the stimulus package. Expectations of social normality in the latter half of the year is expected to lead to an earnings recovery for companies hit hardest by the pandemic, which has helped Value sectors such as industrials, energy and financials to outperform this quarter.
  - 'Growth' stocks underperformed in Q1, with valuations in sectors such as technology and healthcare being impacted heavily by rising yields. Bond yields are often used as the discount rate for future earnings. Growth company valuations are based on long-term earnings growth and so are very sensitive to changes in this discount rate. In contrast, value company valuations tend to be based more on shorter-term earnings. In addition, value sectors tend to be those that benefit from cyclical economic recovery. The MSCI World Growth index gained only +0.3% over the quarter, compared to the +9.8% of the MSCI World Value index.
  - While UK equities lagged other developed markets, both the FTSE 100 (+5.0%) and FTSE All-share (+5.2%) indices delivered positive returns. Value stocks, such as financials, which make up a large proportion of the FTSE 100, performed strongly.
  - The Euro Stoxx 50, performed strongest over Q1, returning +10.8%. Attractive valuations and the approval of a coronavirus recovery plan outweighed concerns surrounding the slow vaccine rollout.
  - Japanese equities had another strong quarter, with a return of +7.7%. Strong corporate results and the outperformance of cyclical and value stocks led the market rally.
  - Emerging market equities returned only +2.2%, measured by the MSCI Emerging Markets index. With many Emerging markets having issued debt in US Dollars, the expected recovery in the US economy and hence the US Dollar has inhibited returns so far this year, despite rises in commodity prices aiding many emerging market economies.

- Bonds, in general, had a poor quarter as yields jumped across the board, and bond prices fell substantially. The extent of the price drop was such that Q1 2021 was one of the worst quarters for US Treasuries since 1980. In general, relatively higher risk fixed income indices (e.g. high yield bonds) outperformed lower risk indices (e.g. Government Bonds). In terms of regions, Eurozone bonds outperformed both US and UK bonds.
    - 10-year US Treasury yields started the quarter at +0.91% and ended the quarter at +1.75%. While yields are still low from a historical standpoint, the change was sharp and significant in size. It impacted other asset classes and sparked further discussions on government deficit spending and the loose monetary policies of central banks, though the Federal Reserve reaffirmed its commitment to low rates.
    - 10-year UK Gilt yields rose from +0.20% to +0.85%. At the start of the quarter, market concerns around the Bank of England policy were focused on the risks of negative rates; by the end, concerns focused on when rates would rise.
    - Most explanations for the yield increases centre on higher inflation due to the new US stimulus package, COVID-19 vaccination drives and a general view of a rapid post-COVID economic recovery. These increases were concentrated in longer duration bonds –Treasury yields remained flat or even fell at the short-end (sub 1-year maturities).
    - High Yield bonds outperformed Investment Grade bonds. European High Yield bonds returned +2.1%, and US High Yield bonds returned +0.8% in Q1. European Investment Grade bonds returned -0.6%, while the US and UK equivalents returned -4.6% and -4.4% respectively. While bond total returns were in general greater for higher risk bond indices, the US was the exception as US Treasuries returned -4.3%, marginally above the return of US Investment Grade Bonds.
- Commodities experienced another strong quarter, particularly in the energy and industrial metals space, which led some analysts to assert that we are entering a new bull market, or even a commodities "supercycle". The combination of infrastructure spending, global recovery and production constraints have led to strong recoveries from last year's lows, with many industrial metals rising above their pre Covid-19 values.
    - Brent Crude oil had a strong quarter (+22.7%), reflecting both the improving outlook for global demand and the supply constraints imposed by both the OPEC+ production cuts and the diminished supply from US shale production. The US Energy Information Administration expects global demand to grow by 5.4 mb/d this year to 96.4 mb/d. This would be a recovery of 60% of the demand loss in 2020.[2]
    - Copper had another strong quarter posting a +13.5% rise in price per pound, finishing the quarter at US$4.0/lb. Demand from infrastructure stimulus, along with thematic trends in renewable energy and electric vehicles, have sustained optimism for future demand growth while disruption in supply from the pandemic in Chile and Peru (the world's two largest copper ore exporters), has also supported the metal's price rise.
    - Following on from the strong price recovery in Q4, natural gas prices rose slightly over the quarter by +2.7% to US$2.61/MMBTU while peaking in mid-February.
    - In contrast to energy and industrial metals and despite the fears of rising inflation, the price of gold suffered heavily during Q1 (-9.6%), with prices down to US$1,714 per troy ounce.
- As in Q4, global listed property delivered strong returns, with the FTSE Global Nareit index up +6.0% in Q1. Geographically, North America performed particularly strongly.
    - Green Street Advisor's US Commercial Property Price Index rose by +2.6% over the quarter. The index is still -5% below pre-COVID levels and there is wide sub-sector dispersion. Their European Commercial Property Price Index rose +2.5% in the quarter, putting it just below the pre-COVID peak[3].
    - The Nationwide UK house price index continued to rise, albeit at a slower pace than in Q4 2020, with a +1.1% rise compared to last quarter's +2.9%. Annual house price growth was +5.7% compared to +7.3% at the end of 2020.

Sterling in Q1 continued to perform strongly, rising against both the Euro (+5.2%) and the Dollar (+1.1%). The UK's service-based economy is seen as likely to benefit from a post-COVID rebound and the relatively rapid vaccination programme supports this view. The Dollar reversed its previous trend, with the Dollar Index Spot rising +3.7%, and rising +4.0% against the Euro on the back of greater expectations for a US economic rebound and despite the new

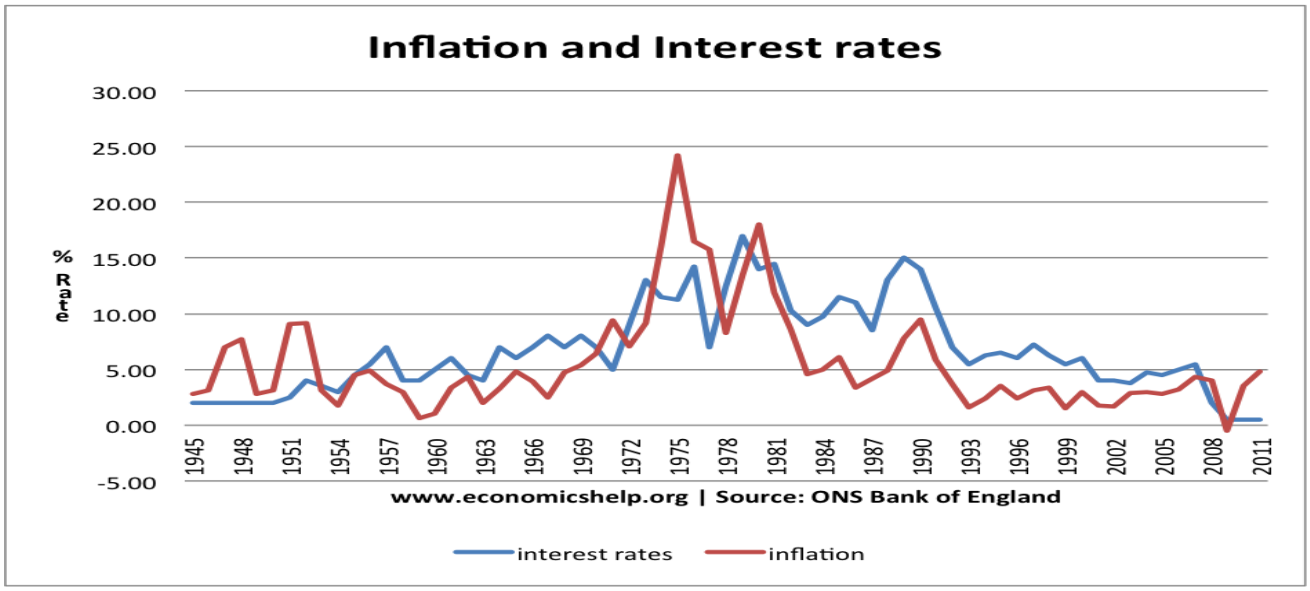
[2] IEA "Oil Market Report – February 2021", February 2021
[3] Green Street Commercial Property Price Index, April 2021

government fiscal commitments. A slower vaccination programme and the new wave of outbreaks in Europe dampened the Euro.

Global Outlook

Regarding the COVID-19 pandemic, my assumptions are that whilst new strains are likely to emerge, the current crop of vaccines or their modified successors will be efficatious enough for global economies to reopen over the next year. I would assume annual vaccinations become the new normal as we are unlikely to eliminate all strains of COVID-19 globally in the short term. The oulook for vaccination rates and the emergence of new strains will dictate market direction in the immeadiate future but I believe it is the outlook for inflation which will set the tone for investment markets for much of the next decade. It is therefore worth concentrating on this element and checking that the Fund is well positioned to perform in a number of different inflation scenarios.

As we exit the current round of economic lockdowns, the enforced savings by those who have remained employed or on furlough and whose health has not been impacted by the pandemic will increasingly be spent, boosting economic growth. This comes at a time when central banks are looking to keep interest rates at very low levels for the next few years and as governments globally look to increase fiscal spending to further boost economic growth. I believe the policy debate has shifted in a number of areas with previous minority views now becoming the new concensus and it is this change in thinking which will influence the economic environment going forward.



The chart above is from the Bank of England and shows UK interest rates and inflation over time. The two OPEC enforced oil price increases in 1974 and 1979 can be clearly seen but it is the appontment of Paul Volker as Chairman of the US Federal Reserve which is credited with bringing inflation under control. He was appointed in 1979 and within a few months committed to bring inflation under control by raising interest rates above the rate of inflation and keeping them there for as long as it took to bring inflation under control even if this meant driving the US economy into a recession.

Interest rates remained above inflation throughout the majority of the next 40 years with the rate of inflation falling through out this period until the Global Financial Crisis of 2008/9. Since then inflation has been subdued and often below central bank targets of around 2% (either explicitly or implicitly set). Over the last ten years the inflationary concern has shifted from it being too high to it being too low. The fear of stagnation and disinflation has taken hold. This is perhaps most recently seen in the August 2020 announcement by the US Fed that it was shifting its inflation target from a maximum of 2% to an average of 2% over th economic cycle, thus accepting that inflation could exceed 2% if it had previously been

below that level for a proloinged period (as has been the case). Put simply, central banks now fear disinflation and falling prices more than they do rising inflation and therefore policy risks will be bias to overshootiing inflation targets not undershooting.

This shift in thinking has occurred in tandem with a policy shift around the acceptable scale of government indebtedness and spending across many of the developed economies. The support provided by governments to the Global Economic Crisis of 2008/9 is seen, in hindsight, as too little too late. Policy markers and market participants now believe you need to respond to a crisis by hitting early and hitting hard. This risk again has shifted with the accepted wisdom now being that under spending to counteract a crisis is the mistake, not over spending. With an electorate unaccepting of austerity, governments are content to accept the new, higher spending, wisdom.

We are now in a world where central banks will take risks of an overshoot in inflation and Governments receive little criticism for raising their indebtedness and spending heavily. This is coming at a time when many consumers have built up savings and have a high propensity to spend.

Trying to put some numbers on this is difficult but the US is the most extreme example here and quoting from a recent Financial Times interview of Larry Summers who worked in both the Clinton and Obama administrations gives the following figures:

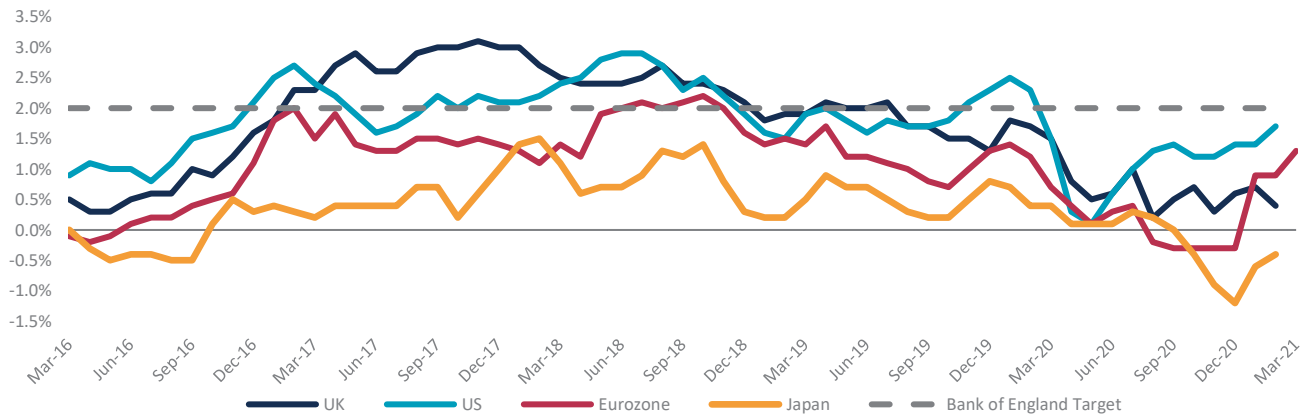
- US$20-25bn of lost monthly wages due to covid, say US$300bn over the year.

Set against this

- US$900bn Stimulus package agreed in December 2020 by the incoming Biden Administration
- The proposed US$2.25tn infrastructure spending plan currently being discussed in Congress.

These two packages account for 20-25% of US annual GDP and to over 10 times the estimated hit to personal finances from the pandemic. This comes at a time when the US Personal Savings Rate is estimated to have increased from 7.6% in 2019 to 13.7% in 2020 amounting to an extra £1tn of enforced savings.

5-Year Consumer Price Inflation (CPI) to 31 March 2021



In the short term inflation is already rising. It is calculated as the year on year change in prices and so the fall in prices 12 months ago, as the pandemic hit, will naturally mean a rise in prices as the earlier figures fall out of the calculation.

The chart below shows the expected rise in US inflation as the historic figures for last year fall out of the calculation. This shows US inflation as likely to hit 3.0 by May 2021.

Source: Unigestion

Covid-19 destroyed demand through the imposed economic lockdowns, but it did also reduce supply as a number of businesses will be unable to recover. The question remains how much this potential mismatch of rapidly improving demand and constrained supply will result in higher inflationary pressure?

Conclusions:

1. We know that inflation will rise over the next two months due to the method of calculation.
2. We know the major developed economies are likely to experience a rapid increase in consumer spending as the enforced savings of the last year are spent.
3. Longer term we suspect that policy mistakes are now more likely to be on the upside for inflation than the downside.

My expectation is that US inflation may remain close to or above 3% for the rest of this year without any reaction from the US Fed in raising rates. Rate rises will only happen if the markets force bond yields higher, therefore the risk for bond yields remains to the upside (prices to fall).

Longer term, there remain a number of strong disinflationary forces e.g. the speed of technological change and the demographic profile of much of the developed world. The longer term outlook for inflation is therefore uncertain but with inflation rising in the near term, market concern will remain on the upside.

The Fund has a relatively low exposure to Government Bonds having switched the Baillie Gifford Fixed Interest portfolio, which included an exposure to Government Debt, to a new Fidelity portfolio which focused on Investment Grade Debt, last year. The historic Fidelity Fixed Interest portfolio, which does include an exposure to Government Bonds was retained at that time for liquidity reasons.

The Fund is increasing it's exposure to real assets which should show some correlation to rising inflation via the allocation to International Property, although it will take a couple of years for this money invested.

Fidelity are presenting their UK property portfolio at this Pensions Committee meeting and post this a discussion should be had about whether the Fund should increase its weighting in this portfolio back to the 5% weighting set in the Strategic Benchmark.

A rise in interest rate expectations may weigh more heavily on 'Growth' style stocks, this may provide a headwind to the Baillie Gifford Global Alpha portfolio but their strong investment process and underlying stock selection should go some way to counteract this.

Performance report

Asset Class/ Manager	Global Equities/ Baillie Gifford
Fund AuM	£598m Segregated Fund; 44.8% of the Fund
Benchmark/ Target	MSCI All Countries World Index +2-3% p.a over a rolling 5 years
Adviser opinion	Manager continues to exceed their performance target significantly
Last meeting with manager	Presented at the Jan Committee meeting. John Arthur/John Carnegie by phone
Fees	0.65% on first £30m; 0.5% on next £30m; 0.35% thereafter

Although the portfolio underperformed by around 1% this quarter it has still outperformed by over 15% in the last 12 months which is a quite incredible achievement. With 'Growth' as an investment style underperforming 'Value' this quarter perhaps the underperformance was to be expected. With a rapid economic recovery now predicted, economically sensitive sectors of the economy like finance, manufacturing and consumer cyclicals should be expected to do well, this should lead to the continued recovery in 'Value' stocks. However, whilst this may provide a headwind to the Baillie Gifford's investment approach which focuses on high growth companies, I remain impressed by the intellectual rigour and thought leadership they show and their understanding of the market dynamics. The performance of the last 12 months will not be repeated but I do not expect this to be unwound going forward.

Asset Class/ Manager	Global Equities/MFS
Fund AuM	£293m Segregated Fund; 22.0% of the Fund
Benchmark/ Target	MSCI World Index
Adviser opinion	meeting long-term performance targets, underperforming short-term
Last meeting with manager	Phone call during the quarter: Elaine Alston/John Arthur
Fees	0.6% on first £25m; 0.45% on next £25m; 0.4% thereafter

The MFS Global Equity portfolio outperformed in the first quarter by approximately 1% but, following a very poor second quarter 2020 performance, as the pandemic struck, the portfolio is still behind its index over the last 12 months. I would expect some outperformance of this portfolio going forward and it acts as a useful counterweight to the Baillie Gifford Global Equity portfolio.

The manager is presenting at this committee meeting and will give a fuller account of performance at that time.

Asset Class/Manager	UK Aggregate Bond fund and UK Corporate Bond Fund/ Fidelity
Fund AuM	£86m Unit Trust; 6.4% of the Fund / £65m unit trust; 4.9% of the Fund
Performance target	50% Sterling Gilts; 50% Sterling Non-Gilts; +0.75 p.a rolling 3 year
Adviser opinion	Manager continues to meet long-term performance targets
Last meeting with manager	Phone call during the quarter: Pa0ul Harris/John Arthur
Fees	0.35% on first £10m; 0.3% on next £10m; 0.21% on next £30m; 0.18% thereafter

Following the transfer of the Baillie Gifford Fixed Interest portfolio across to Fidelity and the decision by the Committee not to invest all the Fund's Fixed interest assets into the Fidelity UK Corporate Bond portfolio, the Fund now has two similar Fidelity Fixed Interest portfolios.

The UK Aggregate Bond Fund has a benchmark which is 50% UK Gilts and 50% UK non-Gilts; the UK Corporate Bond Fund has a benchmark consisting entirely of UK Investment Grade Corporates and, as such, contains slightly higher credit risk.

Portfolio	4Q20 performance	Duration	Yield
UK Agg Bond	-5.9%	10.5 years	1.2%
UK Corp Bond	-3.9%	8.2 years	1.7%

10-year UK Government Gilts yield rose from 0.2% at the start of the quarter to 0.8% by the end, an increase of 0.6% over the quarter. This back up in yields (fall in prices) impacted the performance of the two Fixed Interest portfolios. If you multiple the change in yield by the approximate duration of each portfolio you get the impact of the yield change on prices, i.e. for the Sterling Corporate portfolio with 8 years of duration a 0.6% rise in yields equates to a -4.8% fall in prices (0.6% x 8) for the Sterling Aggregate portfolio, which has a duration of 10 years the impact is higher at -6% (0.6% x 10). The Sterling Corporate portfolio recouped a part of the fall through credit selection. The Sterling Aggregate portfolio has a 50% weighting in UK Government Gilts and a higher credit quality and as such has less scope add value through credit selection.

My central assumption remains that UK Gilts yields will rise further through the remainder of this year and as such I would expect both of these portfolios to add little value in the short term. I believe the UK Corporate Bond portfolio is likely to outperform the UK Aggregate Bond portfolio over the long-term due to the higher yield available in UK Investment Grade Bonds over UK Government Gilts more than compensating for the increased credit risk in the portfolio.

Asset Class/Manager	Multi Asset Income / Schroders
Fund AuM	£111m Pooled Fund; 8.5% of the Fund
Performance target	LIBOR +5% including a yield of 4% per annum
Adviser opinion	Slightly disappointing to date
Last meeting with manager	By phone during the quarter: John Arthur/ Russel Smith/Remi Olu-Pitan
Fees	0.35% of Fund value

The portfolio rose slightly over the quarter with Equities and High Yield Credit providing a positive return and Investment Grade; Government Bonds and Emerging Market debt falling. The expectation is for Government Bond yields to rise further (prices fall) during the next 12 months and as such they are unlikely to provide a useful return, even during periods of market stress. With this in mind, the portfolio manager has been increasing exposure to Real Estate, Infrastructure and Insurance linked assets, which, whilst they do not provide the natural hedge in a falling equity market that Government debt has done in the past, they are a stable source of income and, as such, should support the portfolio through periods of higher market volatility.

Asset Class/Manager	Multi Asset Income / Fidelity
Fund AuM	£133m Pooled Fund; 10.1% of the Fund
Performance target	LIBOR +4% including a yield of 4% per annum
Adviser opinion	Too early to make any assessment
Last meeting with manager	By phone during the quarter John Arthur/Paul Harris
Fees	0.4% on first £20m; 0.3% on next £30m; 0.25% on next £100m; 0.18% thereafter

The Fidelity Multi-Asset Income portfolio was flat over the quarter with Equity positions adding value and defensive assets falling. The manager continues to take a selective approach to adding to risk assets, focusing on UK Equities and Global Financials whilst selling down the holding in Investment Grade Bonds in the belief that yields have further to rise as the global recovery becomes more entrenched.

Fidelity have a lower return target at Cash +4% to Schroders Cash +5%. This means that the Schroders portfolio is likely to have a higher Equity weighting and Equity risk as it chases a slightly higher return. Both portfolios are currently yielding above the target 4% per annum and this yield is distributed to the Fund each month to cover any cash outflow.

Asset Class/Manager	UK Commercial Property / Fidelity
Fund AuM	£46m Pooled Fund; 3.5% of the Fund
Performance target	IPD UK All Balanced Property Index
Adviser opinion	Has outperformed the peer group during the recent market turbulence
Last meeting with manager	Phone calls during the quarter John Arthur/Paul Harris
Fees	0.75% of Fund value

The manager is presenting to the Committee at this meeting and has been asked to cover the current market environment and wide dispersion of returns from different sub-sectors of the UK property market and the outlook for the four major redevelopments currently occurring within the portfolio. These redevelopments account for 16% of the asset value of the portfolio at the current time and the manager retains a high conviction that each of these properties can be re-let upon completion at a higher yield than prior to the redevelopment. Once this has been achieved, the independent valuer should revalue each property upwards to reflect the higher ongoing cashflow thus underwriting the value of the portfolio for the next couple of years.

The UK Commercial Property portfolio managed by Fidelity rose by 2.7% over the quarter and has returned 2.4% over the last 12 months. The portfolio has a low exposure to retail and hospitality assets and has achieved rental collection of over 90% since the pandemic struck with all outstanding rents being actively managers with each individual tenant.

The four properties currently undergoing refurbishment are as follows:

- Industrial Units in Wigan – valued at 5% of the portfolio AuM. Refurbishment completed in August 2020 and currently being marketed although this is being delayed due to the current lockdown. The expectation is to achieve a rent above the previous level.
- Office in Cardiff – The client exercised a break clause in the lease enabling them to vacate the property earlier than expected. This property is now being refurbished and completion was due end November 2020. The energy efficiency of the property has been improved and the expectation is to achieve a rental level 10%+ above the previous rent.
- Office in Southampton – This was a planned redevelopment due to lease expiry. Planning permission has been granted to add a fourth floor and infill the atrium with completion expected in mid-2021. The manager is targeting an uplift in rent of over 25% upon completion of the refurbishment.
- Barley Wood where the manager is looking for change of use from Office to Industrial.

The current vacancy rate is very high at 21% but over 16% of this relates to the four properties commented on above.

Rent collect for the portfolio remains above industry peers which has enabled the portfolio to maintain distributions close to pre COVID-19 levels.

Asset Class/Manager	International Property / Morgan Stanley
Fund AuM	US$80m(£57.5M)/ Limited Partnership; 0.0% of the Fund
Performance target	Absolute return
Adviser opinion	
Last meeting with manager	Phone calls during the quarter John Arthur/Gareth Dittmer
Fees	

I would expect an initial drawdown this quarter of up to £5m as the fund manager is currently negotiating terms with its initial investment which is a distribution site in the US. The Fund currently is estimated to have sufficient cash to cover this investment. A further three potential investments are undergoing due diligence, a distribution centre in Tokyo, a small distribution centre in India and a family run hotel in Vienna. The Fund is likely to take three to four years to fully drawdown the US$80m commitment and because it will start distributing cash from any completed sales before that date, the maximum amount drawn down at any one time is unlikely to surpass US$70m. The first Shareholders Advisory Committee meeting will not be until the Autumn of this year and the Fund has an observer seat on this committee.